THE ROYAL BANK OF CANADA

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Thursday, January 12, 1978

There is a Bright Side.

An address delivered by
W. Earle McLaughlin,
Chairman and
Chief Executive Officer
The Royal Bank of Canada

It would be foolish for anyone addressing shareholders today to deny that we have serious problems in Canada. It is also obvious that these problems affect the banking industry.

Yet I fear that the unity debate, which quite properly occupies so much of people's time, is overshadowing other pressing concerns —economic problems which, in their own way, are equally perplexing. So, I have chosen to dwell on some of these today.

Since it is all too easy for businesspeople to stand up and lament—more often than not blaming their problems on somebody else—I want to lead off by reminding everyone that there is much that is "right" about Canada and its economy today. There is a bright side.

However, an impression exists—and it can be backed up by hard statistics—that economic conditions are much better in the United States than in Canada. As a consequence Canadians once more are being lured South to the U.S. as a place to live, work and invest, as if by a powerful magnet. And so it has been throughout much of Canada's history. For in order to build our Canadian nation, we have had to stubbornly resist the attractions of life in the United States. After all, there are certain "built-in" costs in being Canadians—such as smaller domestic markets, an eight-month heating season, and topographical barriers that generally run 90 degrees to our internal channels of commerce.

But it seems that memories are short because it is only in the last two or three years that our performance has looked so poor in comparison with that of our American neighbours. Examining the past seven years as a whole, we Canadians have outperformed the Americans by a wide margin—by almost any economic yardstick you might propose.

For example, over the past seven years—and I take that time period as a purely arbitrary medium-term yardstick since virtually any other reference period would do—personal income in Canada, in real terms, has increased by 38 per cent, and that's even taking today's weaker Canadian dollar into account. The comparable American figure is only 17 per cent. And if anyone wanted to make a comparison in terms of consumption spending, the results would be of the same order of magnitude. In other words, average Canadians have improved their material standard of life much more than average Americans have. To be sure, the gap between U.S. and Canadian living standards is still wide, but it has narrowed significantly.

Despite our unemployment, we should not forget that we have been creating new jobs 50 per cent faster than the U.S.

In another vital indicator—total investment in the economy—we Canadians have also outperformed our neighbours to the South, the past 12 to 24 months notwithstanding. Over the past seven years, for example, total investment spending in Canada increased by 168 per cent. The comparable U.S. figure is only 107 per cent.

Finally, at a time when we all know that profits are inadequate and return on investment insufficient in Canada, it is well to remind ourselves that over the same intermediate time period I have been referring to, Canadian corporate profits—after tax—increased by 186 per cent, while American corporate profits on the same basis, increased by 179 per cent.

I quote these statistics not to minimize the serious distortions and problems we face in the Canadian economy today, but rather to suggest that we can easily lose sight of—and lose faith in—the longer-term trend. I, for one, am confident that we Canadians can—and will—turn our country back onto that longer-term trend, though undoubtedly not at the former boom rates.

In the course of my duties I travel a great deal to many parts of the world. This affords me a perspective on the practical affairs and issues confronting many other countries.

When I return home I often ask myself: would I trade my citizenship for that of any other country? And the answer is 'no'. When we stop to think about other countries, their shortages, their inflation, their social problems, the heavy hand of the state, the deterioration of educational standards in the schools, the urban ghettos, armed security guards and buildings behind barbed wire, we realize how blest is this Canada. We should remember that in our current sombre mood.

Now, I must admit that 1978 is not shaping up as the greatest year in economic terms. We will be fortunate to achieve real growth of more than 3 ½ to 4 per cent. But we can live with that; most countries, in fact, will envy us. However, inflation—that corrosive cancer on the market system—will continue at an unacceptable level. That is simply intolerable. Nothing will destroy investment, growth prospects, or rising living standards faster than continued inflation.

But beyond inflation, the vexing peculiarity of Canada's economic condition today is how regional in nature, how spotty, our performance has become. I dislike that term "regional disparities". It is bureaucratic jargon which masks the tragedy that while over 11 per cent of the labour force is out of work in Quebec and over 15 per cent in the Atlantic Provinces, labour supply bottlenecks are a problem in certain categories of the workforce elsewhere. Increasingly, the over-all Canadian averages don't reveal very much. What matters is that most of the West is booming, while most of the East is in the doldrums—or worse.

Granted, this has often been the historical Canadian pattern. We don't grow at an equal pace in all parts of the country. For some time now, the West has been edging ahead. But I must say that these historical tendencies notwithstanding, political uncertainty here in Quebec has been harmful to private business investment. Nothing can camouflage that fact. We at the Royal Bank continue to strive to encourage business not only to stay in—but to come to—Quebec, and I hope that 1978 will see greater realism in government policies to help make this easier.

What about the longer Canadian perspective? I would like to comment upon three particular issues: inflation and controls, the money supply and the Canadian dollar.

Inflation and Controls

Let me talk first about inflation. As it is now calculated—and as I shall mention later, I do not agree with its present method of calculation—it averaged between seven and eight per cent last year, and this year will not be much better.

Why does it continue? I do not want to dwell on the apparent breakdown we have seen in the collective bargaining system in this country, nor upon the unreasonable demands and settlements in certain sectors. These are still built into current costs. Nor do I want to dwell upon the approach to bargaining followed by all too much of Canadian business which, for a time, took the road of granting large wage increases, rather than submitting to harsher disciplines.

I don't intend either to moralize once more about government spending at all levels. The plain fact is that government incomes at all three levels—and with it their budgets—have grown by leaps and bounds, even if a more sober approach is now prevailing. Unfortunately some of our elected representatives fell into the bad, easy habit of saying "yes" when they should have been saying "no".

In short, we all together must share some portion of the blame for the inflation problem. Ottawa, the provinces, and the municipalities are not the sole villains.

I would, however, like to remind this audience that not all increases in the cost of living are inflation, even though they may be popularly called that. Certain relative price adjustments were, and are, inevitable and should not be resisted. This is the type of price change which may be called inflation, but it more accurately reflects the harsh realities of the world marketplace—realities which we cannot control.

For example, in the field of energy alone, Canada will shortly be importing over one-half of its petroleum needs—and even more if incentives for domestic energy producers are inadequate. That has to mean higher prices. So we must accommodate to these inevitable price adjustments, at best slow down their pace, but not prohibit, by fiat, their full and inevitable adjustment.

In 1978, we estimate very roughly that perhaps one or two percentage points of what is called inflation will be due to this "relative price adjustment" in energy.

Agriculture is the other obvious major source of rapid relative price change—with food prices accounting for some 1.7 percentage points of our anticipated price level increase in 1978. Agriculture is important to Canada. Canada helps pay for some of its essential imports by exporting food at world prices—and must continue to do so. When world shortages dictate higher food prices, the country earns more from its food exports to the benefit of us all. We also import a lot of food. When a weaker Canadian dollar dictates higher prices for imported food, that is a consequence of the balance of payments. For either reason, we at home have to pay more for food; that is an inevitable cost we must be willing to bear.

The point I am making is the following: as uncomfortable as our current price increases are—and all Canadians feel the squeeze they are imposing on our living standards—there is no alternative painless remedy to that one large component which represents relative price adjustments, pure and simple. These adjustments are particularly hard on individuals living on fixed incomes, and those whose earnings crowd the poverty line—and those persons must be protected somehow. But to fail to make the necessary adjustments in our over-all consumption patterns is to endanger the entire economy. Thus the sooner we get those adjustments made, the better off we shall be.

This point is relevant when one reflects on our Anti-Inflation Board, now slowly being dismantled—or more accurately, it seems, having its claws sheathed.

AIB controls will still be in effect for much of 1978, and wage increases will be constrained to six per cent at a time when price increases may exceed seven per cent. However, as I indicated, I do not agree with those who would call all of this inflation. By the estimate I have just referred to, only two-thirds of the expected increase in the consumer price index this year will be "pure inflation"; the balance represents the sort of relative price adjustment I have been talking about. When energy prices, or food prices, or any others, increase just because of scarcity, we Canadians must cut back our consumption of those goods. That is exactly what a six per cent wage increase in a seven per cent price increase environment will accomplish.

Now, I for one don't subscribe to the AIB concept on principle—let me get that on the record once more. But if there are to be controls—and by law there are; then setting a wage ceiling below the current rate of price increases is certainly not unrealistic nor unreasonable.

For example, in my observation at least, although gasoline prices have roughly doubled, people seem to be driving as much as ever. If consumers choose to spend their money that way, devoting a larger proportion of their spending power to individual transportation, that is their right. But they should not assume that the part of their income available for other goods and services will stay as large as before. This is what I am talking about when I suggest that adjustments must be allowed to take place and have their impact on real spending, and let's not confuse this with inflation.

The point to remember is this: we can legislate against this type of price increase only at our national peril.

The Money Supply

The second issue I would comment upon concerns the money supply. We have had an enormous expansion of the money supply in Canada in the past seven years. It has increased by two and a half times. And the banking system would seem to have benefited handsomely. That growth shows up in our Canadian dollar deposits and assets, which increased by approximately the same magnitude. In fact, many of my business acquaintances from other industries chide me over the apparent ease with which the banks can increase their "sales". In their view, it is all done for us through some magic by the Bank of Canada.

I would like to correct the impression that a rapidly growing money supply is good for the banking industry—or good for the country.

There is no doubt in my mind that Dr. Milton Friedman got onto something when he reminded us that, in history, rapid expansion of the money supply has been accompanied by rapid inflation and, further, that growth in the money supply has led to growth in inflation.

It is worth pointing out that our total money supply—including foreign currency deposits of residents and government deposits as well—really began to accelerate in 1971, with an over 12 per cent increase. During each of the next three years money supply increased progressively by 13 per cent, 16 per cent and then almost 23 per cent in 1974. We are still paying a price for that excessive monetary growth.

However, the immediate short-run effect was rather pleasant. Business boomed. Inflation worsened a bit in 1972, but did not ring the alarm bells because it was still less than five per cent.

Because money flowed freely, those large wage increases I referred to a short while ago were not really so tough for businesspeople to grant: sales dollars increased just as fast if not faster—which simply illustrates, at the level of the individual company, a general inflation catching hold in the country as a whole.

But then inflation accelerated sharply and the piper had to be paid.

Before very long, those swollen payrolls proved devastating to company earnings. Soon companies were taxed on inflation in addition to real earnings. And corporate balance sheets, distorted by inflation, were none too healthy. Corporate liquidity was depressed. Uncertainty concerning future price levels prompted many business decision-makers to creep into their shells and stop investing. The whole economy slowed down.

When Canadian business suffers, Canadian banking suffers too; loan write-offs climb, earnings growth slackens, capital-to-deposit ratios deteriorate. In short, inflation is just as bad for the banks as it is for everybody else. To have the money supply mushroom, year by year, is a mixed blessing in the short-run, and before very long, decidedly harmful for everyone—banker and non-banker alike.

So how has the money supply been behaving? In the past 12 months, using the definition I previously referred to, the broad money supply—the raw material with which banks operate—has grown by nearly 15 per cent. I would say that is still rather fast, particularly when sustained year after year—and sustained it has been since 1971.

Economic theories, models, and analytical justifications notwithstanding—and I know there are many of them which can be used to justify our present policy in Canada—it is my own common sense hunch that we will not really come to grips with our inflation problem until the money supply growth numbers I have cited are no more than the growth in dollars of national income. And that, I would suggest, should be a target of our monetary policy.

The reply on the other side, I know, is that the Bank of Canada is focussing upon the narrow money supply—M^1 as it is called—as a better, more stable, indicator of the direction of the total economy, and as a better indicator of total credit availability. And M^1 has been growing more slowly—in the range of nine to ten per cent over the past 12 months. Still, I would suggest to you today that a closer examination of that approach is warranted. Inflation is still too serious to continue on our present course. And measuring a money supply at the M^1 level is tantamount to gauging the depth of a deep well by inserting a yardstick. There is more water there than a mere yardstick can measure.

The Canadian Dollar

The final topic I want to deal with today is the Canadian dollar.

This is the 18th Annual General Meeting of the Shareholders of this Bank that I have had the privilege to address as Chief Executive Officer. And I must confess, as I am sure many of you appreciate rather well, that over the years I developed a certain fondness for the subject of the Canadian dollar, and in particular the floating exchange rate. Well, ladies and gentlemen, you will be delighted to learn that I am not going to repeat old speeches. There is no need to. The battle was won in 1970 when we actually did float our dollar once again. And Canada has been well served by it.

In a little over a year, under this free-floating policy, the Canadian dollar dropped from 1.03 U.S. to about 90 cents U.S. It was a sobering decline. But it only illustrates what thousands of independent decision-makers really believed to be the state of affairs in our Canadian economy, i.e., our wage rates, our inflation rate, and the behaviour of our money supply.

When the dollar weakened, some suggested the government should intervene. Some even hinted at the possibility of foreign exchange controls. These, of course, are completely impractical. Such suggestions merely illustrate the typical lack of understanding on the part of some foreign and domestic commentators on Canadian economic affairs. We have conscientiously followed a free-float without foreign exchange controls—and there is no reason to think that this will not continue.

Now I would like to remind you how much better this state of affairs is than intervention by government.

First, the fall of the dollar was an immediate reminder to all Canadians that, as a nation, we have some serious mending to do. The message will be communicated with outstanding clarity when a Canadian tourist going South this winter must pay a substantial premium when buying his foreign currency, or when a Canadian shopper pays more for an imported product.

That message, I'll wager, will get across more effectively than all of AIB's jaw-boning, all of Ottawa's white papers, and all of the speeches by bank chairmen. That is healthy. Before you can get people to change, you've got to get their attention.

Second, a weaker dollar provides a temporary breather for our hard-pressed manufacturing sector, sections of which were—and are—under severe pressure from the flood of imports and our growing uncompetitiveness in cost. But let's not fool ourselves; it may be a pain reliever but, it certainly is not a cure for our ailments.

Finally, our approach continues to give the Bank of Canada freedom to pursue an independent monetary policy—a policy which, as I have suggested, should be tougher in its striving against inflation.

The weaker dollar has had a sobering but salutatory impact.

All in all, let's view the fall of the Canadian dollar with regret, but also with the sort of relief which you feel when you learn that a friend, who has had an accident, has been put into a good hospital. In short, the patient is getting a thorough check-up and will be back on his feet in better health than before—provided we can keep the untrained medical students at bay.

In closing, let me once more remind shareholders all across Canada—indeed, all around the world—that I am fundamentally optimistic about Canada and its prospects, economic and otherwise. This past year has been a difficult one for our nation. It has also been a particularly difficult one for many of our staff living in Quebec. But I am confident. I expect we will all be here for a long time as Canadian citizens.

And I urge you to be optimistic also, and act accordingly. For in my view, the most calamitous thing for us now, and indeed for the nation, would be to be swept away by the waves of pessimism often displayed by too many. I do not feel that way. There is a bright side. I repeat, Canada's economic performance stands proud under most any comparison. We will straighten out our problems—and remain one nation, sea to sea.

W. Earle McLaughlin
Chairman and Chief
Executive Officer

Minutes of the 109th Annual General Meeting of the Shareholders

Montreal, January 12, 1978

The 109th Annual General Meeting of the Shareholders of The Royal Bank of Canada was held at the Head Office of the Bank in Montreal on Thursday, January 12, 1978 at 11:00 a.m. The Chairman and Chief Executive Officer of the Bank, Mr. W. Earle McLaughlin, acted as Chairman of the meeting and the Secretary of the Bank, Mr. R.J. Moores, acted as Secretary of the meeting. The Chairman declared that as notice of the meeting had been duly given and a quorum was present, the meeting was properly convened. The Chairman appointed Messrs. Antoine Y. Lamarre and James W. Knox to act as Scrutineers.

It was moved by Mr. J. Pierre Maurer and seconded by Mr. G. Campbell Eaton that the Minutes of the last Annual General Meeting of the Shareholders of the Bank held on January 13, 1977, a copy of which was sent to each Shareholder as required by the Bank Act, be taken as read and approved.

The Chairman then stated that the motion was open for discussion. There being no discussion, the Chairman then put the motion to the meeting. A ballot was taken and, upon receiving the Scrutineers' Report of the balloting, the Chairman declared the motion duly carried.

The Chairman referred to the Annual Statement, copies of which had been distributed to the Shareholders, and to the Directors' Report, and called upon the Secretary to read the Directors' and Auditors' Reports.

Directors' Report

The Directors of The Royal Bank of Canada have pleasure in submitting to the Shareholders the one hundred and eighth annual Directors' Report as well as the Annual Statement for the financial year ended October 31, 1977, which includes the Statement of Assets and Liabilities of the Bank, the Statements of Revenue, Expenses and Undivided Profits, and of Accumulated Appropriation for Losses of the Bank, the Statements of Assets and Liabilities of Controlled Corporations and the Auditors' Reports with respect to those statements.

In accordance with the usual practice, the assets of the Bank have been carefully valued and provision made for all bad or doubtful debts.

During the year, fifty-four branches were opened and nineteen were closed in Canada; two were opened and nine were closed outside Canada. The total number of branches in operation on October 31, 1977 was 1,595 of which 1,509 were in Canada and 86 were in other countries; in addition the Bank has a financial interest in eighty-five subsidiaries and affiliates throughout the world.

The Directors once again wish to place on record an expression of sincere appreciation to all members of the staff, both in Canada and abroad, for their overall contribution to the success of the Bank during the past year.

Respectfully submitted
(signed) W. Earle McLaughlin
Chairman and Chief
Executive Officer

Montreal
January 12, 1978

The Auditors' Reports were then read by the Secretary (these reports appear on pages 40 and 45 in the Annual Report).

Before calling for the adoption of these reports Mr. McLaughlin said:—

I wish to report that for personal reasons Mr. George Heffelfinger, a director since June, 1971, is not standing for re-election today; and that during the year the Honourable Paul Desruisseaux, a director since January, 1962, also for personal reasons, resigned from the board. I should like to express to these gentlemen our sincere thanks for the contribution they have made to the Bank during their years as directors.

Also with regret, I have to advise you that Mr. Colin W. Webster, who was first elected to the board on January 12, 1950—exactly 28 years ago today—is not eligible for re-election because of the age limitation. During these 28 years Mr. Webster has been an assiduous attender of our weekly board meetings and has taken the keenest interest in the affairs of the Bank. He will be missed from our deliberations and our thanks to him, too, are very warm.

Mr. McLaughlin then addressed the meeting (the text of his address will be found on pages 1 to 5 of the Proceedings). He then called upon Mr. Rowland C. Frazee, President, to address the meeting. (A fuller Report on the Year's Operations by Mr. Frazee is presented on pages 5 to 25 of the Annual Report.)

Though each year is challenging in its own way, I could say that 1977 was exceptionally so, because of the particular concerns we had in Canada with inflation, unemployment, political uncertainty, lagging investment, and a weakening dollar. Royal Bank people can feel a sense of achievement, therefore, in having confirmed the Bank's resilience and health, under very difficult circumstances.

Both in Canada and abroad, our business grew significantly during the past year and once again I propose to use a few charts to illustrate the highlights, after which I shall focus on some of the major changes which have taken place both within the Bank and in the marketplace.

Chart 1

The first chart shows that our balance of revenue after tax was $169 million, up seven per cent from the previous period. On a per share basis, earnings were $4.61, up from $4.30 in 1976.

The growth in earnings was produced exclusively by our international operations, which increased 27 per cent to $55 million, a very strong recovery from the six per cent decline reported in 1976 compared to 1975.

Earnings on the domestic side, at $114 million, were unchanged from the previous year. This was the result of narrower spread and a continued high loan loss provision which more than offset our improved performance in expense management.

Sixty-seven per cent of earnings were from domestic and 33 per cent from international, reflecting a similar division of assets.

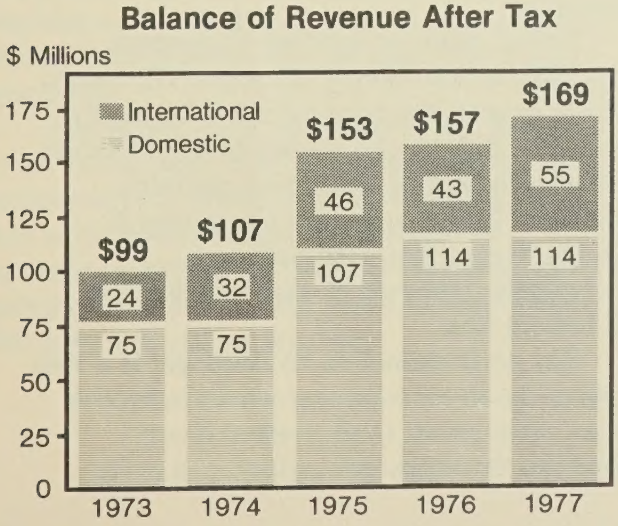

Chart 2

This chart indicates that annual average total assets were $31.8 billion in 1977, up 19 per cent. At the end of the year, total assets reached $34.4 billion. Growth on the domestic side was 16 per cent to $21.8 billion, while international average assets increased 26 per cent to $10 billion. Almost half of this international increase was, however, the result of translating our foreign currency assets, which are primarily loans granted in U.S. dollars, into Canadian dollars at the appropriate exchange rate.

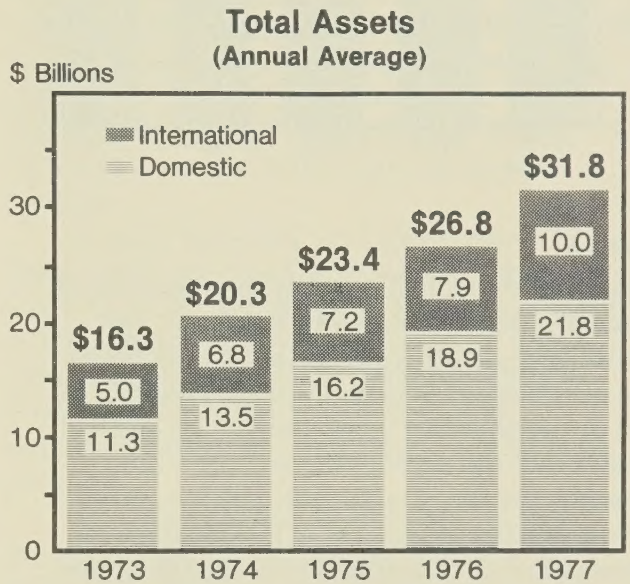

Chart 3

This chart shows the return on assets, one of the major measures of profitability we use. It combines the two previous charts, that is, the balance of revenue after tax and the total average assets, in a ratio. One way of interpreting the return on assets is to say that the Bank earned in 1977, after taxes, 53¢ for every $100 of assets.

It is apparent that the return on assets has declined since the exceptionally favourable financial conditions of 1975. This is the result of a variety of factors, including the freeze on service charges under A.I.B. regulations, our loan-loss experience, our improving but

continued high cost of doing business, and, in particular, the squeeze on spreads in Canada earlier in 1977 when interest rates were dropping.

Return on Assets

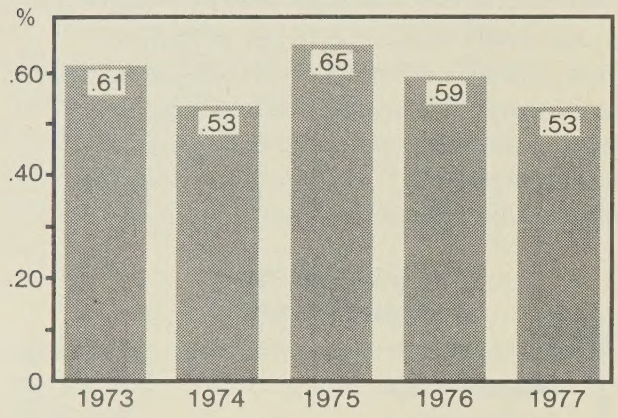

Chart 4

This chart shows a favourable downward trend in the growth of non-interest expenses. The earlier high-growth years reflect high inflation and a strategy of branch openings, automation and development of human resources; and we believe that the strategy will pay off. For example, the Royal is the only major bank to have a significant increase in market share of personal savings deposits over the last five years.

In 1977, we were able to produce a lower increase in expenses in both dollar and percentage terms than either of the previous two years. I am confident that we will have an even lower rate of expense growth in 1978.

Growth Rate of Non-Interest Expenses

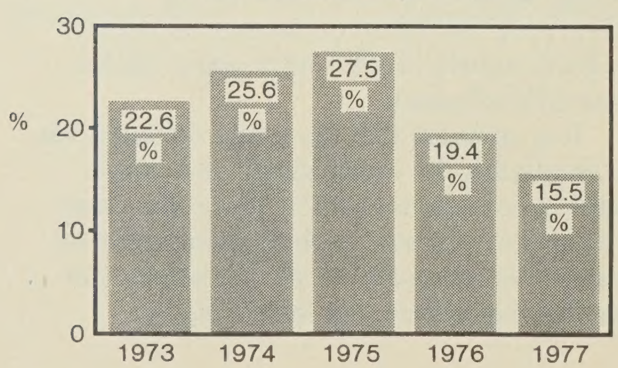

Chart 5

Finally, we are presenting some fully consolidated figures. Under the present Bank Act, we are not permitted to include in our financial statements the assets of controlled or affiliated companies, with the exception of wholly-owned foreign banks. Similarly, our statement cannot include their profits unless the income is paid to us in dividends. The new Bank Act, if it follows the White Paper, will provide for the consolidation of assets and profits of companies which we control, and our share of the profits of most of our affiliates, such as Orion Bank Limited.

If the Act had been in effect now, our results would have been as indicated on the chart, that is $856 million more in assets at year-end and $11.4 million greater after-tax earnings, resulting in an additional 32¢ per share.

Highlights of 1977
Consolidated Results

	Fully Consolidated	Statutory Basis	Difference $	%
Total Assets ($ Millions)	$35,206	$34,350	$856	3%
Balance of Revenue After Tax ($ Millions)	$180.2	$168.8	$11.4	7%
Earnings Per Share	$4.93	$4.61	$0.32	7%

Each year, in addition to presenting financial results, we try to describe the broader context in which we operated, to amplify the meaning of these results. The pattern of our growth does not depend only on our own actions, but also on changing circumstances and priorities in the social and political world around us.

Today, more is expected of business corporations than simply economic efficiency. Society expects the corporation to be highly conscious of the social impact of its objectives, policies and actions. Moreover, society's judgement of the corporation's success in meeting these wider expectations is, increasingly, reflected in ways which affect the bottom line.

Our performance as an employer is a case in point. In an environment where collective action often seems to be preferred over individual flexibility and initiative, it is not

surprising that some people would believe that unionization of bank employees is desirable. While the union movement has achieved much that is positive in many fields, the crucial factor affecting the welfare of employees is the skill and responsiveness of management in providing a fulfilling and challenging work experience, and in meeting employee needs and aspirations.

This is not to say, however, that the quality of management is the only factor. Sometimes, opinion trends in society may be overwhelming, whatever the particular circumstances of a specific company may be.

This question has, of course, concerned us at the Bank during the past year, in which bargaining units were certified in three branches, representing a total of 38 employees.

Challenges are also apparent in other areas. For example, we live in an increasingly activist society, in which citizens band together to express concerns, press for changes, and bring certain policy matters to the attention of the media and the public.

An instance is the question of the economic relationships between Canada and South Africa. Recent events in that tragic country—and recent changes in Canadian policy—have increased the attention being given to the question by Canadians. Additionally, of course, shareholders are aware of the interventions of the Taskforce on the Churches and Corporate Responsibility at our last two annual general meetings of shareholders. This group, and other concerned Canadians, have suggested that Canadian banks undertake to place an embargo on all loans to the government and state agencies of the Republic of South Africa, until that government abandons or significantly changes its policies of apartheid.

The Royal Bank's position in this matter is clear. In the field of international lending, our commitment of policy and principle requires that each *individual* loan proposition be carefully examined not only from the traditional points of view of security, risk and return, but also from a social perspective.

This general policy, applying as it does to all lending decisions, fully covers the wide variety of situations in many different countries —countries with regimes of all political styles— in which economic, social and political situations may be changing quite rapidly.

Thus, interpretation of the Bank's policy might result in our saying yes to a given loan in a given country, while it might equally cause us to refuse another loan to the same borrower, at a different time or for a different purpose. *All* the specific circumstances of *each* loan must be taken into account. It may be considered unfortunate by some, incidentally, that the important rule of banker-client confidentiality prevents the banker, in the absence of the client's authorization, from reporting either the negative or the positive decision.

Overall, we believe our policy gives lending officers a basis of principle, within which they have the flexibility and responsibility to make careful judgements in specific cases. We are convinced this approach is preferable to announcing embargoes on particular borrowers, particular governments or particular countries.

At the same time, it should not surprise anyone if I say that current conditions in a number of countries around the world are not such as to provide a high likelihood of loan propositions which would meet our various criteria of acceptability.

One other effect of changing values in our environment is in the whole area of actual or prospective governmental regulation. It appears that if the public believes its institutions are not adequately responding to its expectations and standards, a natural reaction is to seek government intervention. If, however, institutions such as ours succeed in being in tune with public expectations, calls for regulations should be less likely.

However, in my opinion, the tendency to choose the regulatory option, as opposed to reliance on market and social forces, is proving very costly to the country. To use legislation or regulation to cover every conceivable situation not only increases an already expensive bureaucracy, but often results in lowered effectiveness in our enterprises. In the case of the Bank, for example, our staff must spend a growing amount of time and energy studying proposed legislation and complying with that which has been adopted, not to mention trying to reconcile the sometimes conflicting provisions of different jurisdictions. In the long run, this makes banking services more costly to the community.

Particularly in times of economic slowdown, we Canadians should allow ourselves the minimum of legislation which, while well-meaning, casts such a wide net that it impedes normal and ethical business practices and imposes heavy costs on our society.

Fortunately, not all legislation is of this sort. During the year, our officers have spent time on many pieces of legislation, both federal and provincial. But from a banker's point of view, the most important is the revision of the Bank Act. We have endorsed the basic thrust of the revisions suggested by the government's White Paper, based on the principle of increased competition. For instance, we believe there should be reasonable consistency of the rules under which banking business is conducted, whether by a chartered bank, or by a near-bank.

The same attitude also applies to foreign banks in Canada. We applauded the intention of allowing foreign banks greater access to the Canadian market in return for reciprocal privileges for Canadian banks in other countries. As banking is involved with so much of a country's economic life, we certainly believe that control of Canadian banking must remain essentially in Canadian hands, and therefore we agree safeguards are necessary. But we also are aware that foreign banks are already operating in Canada today—essentially unregulated. A revised Bank Act to get this out on the table seems to us a healthy approach.

We at the Royal Bank are confident of our ability to compete at home and abroad when we all operate under the same ground rules. And if changes in our domestic banking law help open up opportunities for us in other countries, we will do our best to capitalize upon them rapidly and energetically.

Another piece of legislation of major concern is Quebec's new language law—Bill 101.

At the Parliamentary Committee appearance, and in our official brief, we stated our support for the underlying goals of the legislation, which seeks the preservation, enhancement, and expansion of the French language in Quebec, and its wider use in all aspects of the life of Quebec society. We also described the substantial progress made in recent years in the use of French in the operations of our Quebec District.

The language law is now in effect. It therefore seems appropriate to state, as clearly and as briefly as possible, the Bank's current position on it.

First, we remain concerned about the overall climate in which our English-speaking Head Office employees—many of them unilingual—must live. Additionally, although temporary residents may be exempted from the rules which prevent immigrants to Quebec from sending their children to English schools, the difficulties faced by parents with school-age children transferring from elsewhere in Canada to head offices in Montreal are very real. The effect upon the staffing of our own Head Office with the best people available throughout our system remains problematic.

Second, the law has been studied very closely not only by our own officers, but by outside counsel, and because of our status as a chartered bank, engaged in a field of activity which is exclusively under federal jurisdiction, there are many parts of the law which, we are told, are not applicable to our operations. These include articles dealing with labour relations, and with the use of our corporate name in English. Accordingly, there are a number of actions which the law requires of most companies in Quebec, which are not required of us.

On the other hand, there are parts of the law which *are* properly applicable to us, and with which we must comply. Moreover, we will undertake certain actions which, though not strictly required of us, represent sound business policy and good corporate citizenship. One such action was the recent establishment of a language committee to examine the uses and furtherance of the French language in our operations in Quebec, this committee being similar to—but not identical with—the francization committee required of most Quebec companies by law.

All our concerns about the situation in Quebec notwithstanding, the Royal Bank intends to remain involved in Quebec as a financial institution and as an employer. We have operated profitably and as a substantial contributor to Quebec's economy for three quarters of a century, and propose to continue. Additionally, of course, our Head Office, the world headquarters of what is now a major international bank, is located in Montreal. We intend that it remain here, in the confidence that it can continue as a fully effective functioning unit.

Because of the important changes in the social and political environment in which we operate, I have discussed a number of the new kinds of challenges the Bank must meet. But the basic business of banking remains the provision of services to customers. Here too, there are challenges to test the ingenuity and judgement of our staff, at home and abroad.

The significance of our international banking activities is evident in our results. About one-third of our business is in the international sector, and our position and reputation as one of the world's leading banks is of great importance to us. The 1977 results of our international operations were achieved in conditions every bit as difficult as in Canada.

The changing patterns of international finance, coupled with difficult economic conditions in many countries, have required constant vigilance and ingenuity from our international staff, as we serve in complex and volatile markets.

As I have reported before, there has been a shift in emphasis over the past few years from branch-based retail banking in foreign countries, towards a heavier involvement in wholesale banking involving large transactions on the interbank, government, and large corporate level, often through consortia of major world banks. This is a very sophisticated and complex kind of banking, and we can be proud of the record of our own officers in this global arena.

And there are even newer challenges arising. One of these is a pressing need to reappraise the world's funding system and to find new ways to accommodate international capital flows. The large surpluses accumulated by the oil-rich OPEC countries provide a classic example, as these funds seek rewarding investment opportunities. A related concern is the counterpart phenomenon of OPEC's impact on other national economies, including the financing of significant balance of payment deficits resulting from quintupled oil costs.

Indeed, the entire question of the provision of funding for countries whose economies are either not sufficiently developed or not broadly-enough based is one to which both international monetary bodies and the commercial banks must continue to address themselves.

Though earnings from our Canadian operations were less satisfying than those from the international sector, our domestic business reflected continued growth, both in the retail or personal sector, and at the corporate and government level.

One good example of achievement in the personal sector was our residential mortgage operations. Since the 1967 revision of the Bank Act, when banks re-entered the mortgage field, the Royal Bank has granted 202,000 residential mortgages, representing a total of $5.5 billion loaned for housing.

In 1977 alone, we increased our volume over 1976 by some 50 per cent, and granted 39,000 mortgages, a total of $1.5 billion loaned. Our ability to assist so many Canadians with home financing, and our record in doing so, is a matter of considerable pride for all of us in the Bank.

You will recall that during the year there was a drop in consumer loan rates in Canada,

despite the rising administrative costs associated with this type of lending. Rather than change our rate to a new rigid and set rate, we took the opportunity to further refine our TermPlan Loan Program by introducing a flexible rate structure, with rates ranging from 10½ per cent to 14½ per cent, depending on risk, term and security. This allows us to offer closely competitive rates to borrowers who have clearly demonstrated their responsibility, or who provide adequate security, while also giving us the flexibility to lend at reasonable rates to customers who otherwise would not have qualified.

Important as we consider our services to individual consumers, we also place a high degree of emphasis on Canada's independent or smaller businesses, the backbone of the Canadian economy. To meet their special needs we have devised over the past years an independent business program which offers information and counsel as well as financial services. We have also further developed our services for graduating and practising professionals, introducing a life insurance feature in the "seed money" loans we make to interested professionals such as architects, chartered accountants, dentists, engineers, lawyers and medical practitioners.

The Royal Bank also continues to be closely linked with the important fisheries industry in Canada through special programs with the flexibility required by the unique conditions of commercial fishing.

Meanwhile, with our innovative RoyFarm Mortgage Program introducing a 25-year amortized mortgage for land, buildings and debt consolidation, our well-established FarmPlan will provide a complete package of short, medium, and long-term financial services to commercial farmers in Canada, from coast to coast.

Activity in western Canada in the oil and gas industries is at an unprecedented high. In the financing of oil and gas exploration and development, the Royal Bank provides approximately one third of the volume of bank loans required by the Canadian petroleum industry. Production loans expanded by 34 per cent in the last 12 months. Internationally, we played a part in several complex financings of North Sea oil and gas fields where the knowledge we gained will be useful in our handling equally complex northern frontier energy projects.

Considering the crucial importance of energy to the Canadian economy, it is evident that we need a positive approach to energy development in our country. Emphasis on conservation will do much to spin out our supply, but this should not dislodge development of new energy sources as a critical national priority. We should reflect soberly on the fact that we rely heavily on foreign sources of energy which not only affect our balance of payments, but create additional barriers to industrial development.

I would now like to turn to the most important factor influencing our success—the dedication and skill of the Royal Bank's 35,335 staff people. Not only is it appropriate to express appreciation for their contribution and support, but also to highlight the fact that banking is very much a field for flexible, energetic, versatile and innovative people. If ever the caricature image of banking as a dry-as-dust occupation for dull people contained a grain of truth, today's reality is far different. A banking career today offers opportunities and problems to test the ingenuity and scope of the most creative person—and provides, along with material remuneration, the important rewards which come from knowing one is serving the community in a meaningful way. Royal Bank people have every reason to be proud of their role in Canadian society, and of the level of excellence they have achieved in a world which can only be described by the word with which I started this report—*challenging*. They have my sincere thanks for their efforts.

I would also like to thank our 32,276 shareholders for their continuing support and confidence. I and the rest of the Bank's employees appreciate their faith in us and pledge our continuing efforts to merit it.

It was moved by Mr. Ian D. Sinclair and seconded by Mr. W.O. Twaits, C.C.—

THAT the Directors' Report and the Annual Statement for the financial year ended October 31, 1977, as well as the Auditors' Reports with respect to the Statements included in the Annual Statement be adopted.

The Chairman then stated that the motion was open for discussion. There being no discussion, the Chairman then put the motion to the meeting. A ballot was taken and, upon receiving the Scrutineers' Report of the balloting, the Chairman declared the motion duly carried.

It was moved by The Hon. Lionel Chevrier and seconded by Mr. E.C. Lipsit—

THAT Mr. Douglas J. Low, C.A. of Deloitte, Haskins & Sells, and Mr. W. Douglas Lennox, C.A., of Price Waterhouse & Co., be and they are hereby appointed to be the auditors of the Bank until the next ensuing Annual General Meeting of the Shareholders, and that their remunerations be fixed at a sum not to exceed $270,000 to be divided between them.

The Chairman then stated that the motion was open for discussion. There being no discussion, the Chairman then put the motion to the meeting. A ballot was taken and, upon receiving the Scrutineers' Report of the balloting, the Chairman declared the motion duly carried.

It was moved by Mr. Neil F. Phillips and seconded by Mr. Pierre A. Salbaing—

THAT W. Earle McLaughlin, Rowland C. Frazee, J.K. Finlayson, W.D.H. Gardiner, R.A. Utting, B.J. McGill, T.S. Dobson, W.L. Arthur, J.C. McMillan, R.C. Paterson, A.R. Taylor, and H.E. Wyatt, executive officers of The Royal Bank of Canada, and each of them acting alone, be and he is hereby appointed the true and lawful attorney of The Royal Bank of Canada, for and in the name of The Royal Bank of Canada, to attend and vote or appoint proxies to attend and vote at any and all meetings of the Shareholders of each corporation controlled by the Bank and of any and every other corporation any of whose outstanding shares are for the time being held by the Bank, and at any and all adjournments of such meetings in respect of the shares held by the Bank in any such corporation, the foregoing to remain in full force and effect until the next Annual General Meeting of the Shareholders of The Royal Bank of Canada.

The Chairman then stated that the motion was open for discussion. There being no discussion, the Chairman then put the motion to the meeting. A ballot was taken and, upon receiving the Scrutineers' Report of the balloting, the Chairman declared the motion carried.

The Chairman declared the meeting open for the nomination of directors.

Mr. Angus MacNaughton nominated the following persons to be Directors of the Bank:

The Rt. Hon. Lord Adeane, D.S. Anderson, John A. Armstrong, Ian A. Barclay, T.J. Bell, M.C., G.H. Blumenauer, G. Allan Burton, D.S.O., E.D., LL.D., R.B. Cameron, O.C., D.S.O., A.B. Christopher, John H. Coleman, Frank B. Common, Jr. Q.C., F.M. Covert, O.B.E., D.F.C., Q.C., L.G. DesBrisay, Mrs. Mitzi S. Dobrin, J.E.L. Duquet, Q.C., G. Campbell Eaton, M.C., C.D., J.K. Finlayson, Rowland C. Frazee, W.D.H. Gardiner, Kelly H. Gibson, Floyd D. Hall, Sir Charles E.M. Hardie, C.B.E., David S. Holbrook, L.G. Lumbers, P.L.P. Macdonnell, Q.C., Clifford S. Malone, F.C. Mannix, J. Pierre Maurer, W. Earle McLaughlin, J.P. Monge, Pierre A. Nadeau, Paul Paré, Neil F. Phillips, Q.C., Herbert C. Pinder, Claude Pratte, Q.C., Charles I. Rathgeb, A.M. Runciman, Pierre A. Salbaing, P.R. Sandwell, Ian D. Sinclair, P.N. Thomson, John A. Tory, Q.C., W.O. Twaits, C.C., C.N. Woodward.

Mr. Frank Cochrane seconded the nominations.

The Chairman then asked if there were any further nominations.

It was moved by Mr. Ian Mair and seconded by Mr. Paul Nepveu—

THAT the nominations be closed and that each of the persons nominated be elected a Director of the Bank.

The Chairman then stated that the motion was open for discussion. There being no discussion, the Chairman then put the motion to the meeting. A ballot was taken and, upon receiving the Scrutineers' Report of the balloting, the Chairman declared the motion duly carried.

Mr. Pierre A. Nadeau, expressed the thanks of the Shareholders to the President as well as the officers and staff of the Bank for the efficient manner in which they have performed their respective duties.

Mr. Rowland C. Frazee replied on behalf of the officers and Miss Suzanne Labarge replied on behalf of the staff.

The Chairman asked if there was any further business to come before the meeting. He then recognized a shareholder as representative of the Taskforce on the Churches and Corporate Responsibility and a shareholder as representative of the Anglican Church in Canada, both of whom presented statements bearing on the Bank's lending policies to the Governments of South Africa and Chile. The Chairman replied making reference to the Bank's previously stated positions in this regard and indicated that printed copies of these statements are available to shareholders on request.

The Chairman then recognized a shareholder who made reference to certain French unilingual branch signs in Montreal.

There being no further business to transact, the Chairman declared the meeting terminated.

(signed) R.J. Moores
Secretary

(signed) W. Earle McLaughlin
Chairman